

UNION ELECTRIC COMPANY

BEFORE THE

ILLINOIS COMMERCE COMMISSION

DOCKET NO. 03-0009

**PROPOSED GENERAL INCREASE
IN
NATURAL GAS RATES**

**DIRECT TESTIMONY
SUBMITTED BY
DAVID J. EFFRON
ON BEHALF OF
PEOPLE OF THE STATE OF ILLINOIS**

APRIL 2, 2002

AG Exhibit 1.0P

UNION ELECTRIC COMPANY
DOCKET NO. 03-0009
TESTIMONY OF DAVID J. EFFRON
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1 **I. STATEMENT OF QUALIFICATIONS**

2 Q. Please state your name and business address.

3 A. My name is David J. Effron. My business address is 386 Main Street, Ridgefield,
4 Connecticut.

5
6 Q. What is your present occupation?

7 A. I am a consultant specializing in utility regulation.
8

9 Q. Please summarize your professional experience.

10 A. My professional career includes over twenty years as a regulatory consultant, two
11 years as a supervisor of capital investment analysis and controls at Gulf & Western
12 Industries, and two years at Touche Ross & Co. as a consultant and staff auditor. I
13 am a Certified Public Accountant, and I have served as an instructor in the business
14 program at Western Connecticut State College.
15

16 Q. What experience do you have in the area of utility rate setting proceedings?

17 A. I have analyzed numerous electric, telephone, gas and water rate filings in different
18 jurisdictions. Pursuant to those analyses, I have prepared testimony, assisted
19 attorneys in rate case preparation, and provided assistance during settlement
20 negotiations with various utility companies.

21 I have testified in approximately two hundred cases before regulatory
22 commissions in Alabama, Colorado, Connecticut, Florida, Georgia, Illinois,
23 Indiana, Kansas, Kentucky, Maryland, Massachusetts, Missouri, New Jersey, New

1 York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas and
2 Virginia.

3
4 Q. Please describe your other work experience.

5 A. As a supervisor of capital investment analysis at Gulf & Western Industries, I was
6 responsible for reports and analyses concerning capital spending programs,
7 including project analysis, formulation of capital budgets, establishment of
8 accounting procedures, monitoring capital spending and administration of the
9 leasing program. At Touche Ross & Co., I was an associate consultant in
10 management services for one year and a staff auditor for one year.

11
12 Q. Have you earned any distinctions as a Certified Public Accountant?

13 A. Yes. I received the Gold Charles Waldo Haskins Memorial Award for the highest
14 scores in the May 1974 certified public accounting examination in New York State.

15
16 Q. Please describe your educational background.

17 A. I have a Bachelor's degree in Economics (with distinction) from Dartmouth
18 College and a Masters of Business Administration Degree from Columbia
19 University.

20
21 **II. INTRODUCTION AND SUMMARY OF TESTIMONY**

22 Q. On whose behalf are you testifying?

23 A. I am testifying on behalf of the People of the State of Illinois.

1

2 Q. What is the purpose of your testimony?

3 A. I am recommending rate base and pro forma operating income for Union Electric
4 Company, d/b/a AmerenUE, ("UE" or "the Company") in this rate case, based on
5 the adjustments to the Company's position that I have identified in my review and
6 analysis of the Company's presentation. I am also presenting a calculation of the
7 Company's present revenue deficiency.

8

9 **III. REVENUE REQUIREMENT ISSUES**

10 **A. SUMMARY**

11 Q. What revenue deficiency or excess have you calculated?

12 A. Based on the test year consisting of the 12 months ended June 30, 2002, I have
13 calculated a rate base of \$14,473,000 and pro forma operating income under present
14 rates of \$143,000. For the purpose of calculating the revenue deficiency, I have
15 included a return on equity of 10.65% in the overall rate of return, based on the
16 Commission's findings in Docket Nos. 98-0546, the last gas base rate case for UE.
17 Based on an overall rate of return of 8.762%, the Company presently has an
18 operating income deficiency of \$1,125,000, which translates into a revenue
19 deficiency of \$1,882,000 under present rates. The calculation of this revenue
20 deficiency is summarized on my Schedule A.

21

1 **B. RATE BASE**

2 **1. PLANT IN SERVICE**

3 Q. Is the Company proposing to adjust its rate base for post-test year additions to plant
4 in service?

5 A. Yes. The rate base adjustment on UE Schedule B-2.1 recognizes the effect of
6 additions to plant in service forecasted to take place after the end of the June 30,
7 2002 test year. The adjustment reflects additions to mains and services associated
8 with the Alton gas main replacement project and increases plant in service included
9 in rate base by \$2,314,000. In conjunction with this adjustment, the Company has
10 also recognized an increase in the balance of accumulated depreciation directly
11 associated with that addition to plant in service. The net effect of the adjustment
12 being proposed by the Company is to increase its test year rate base by \$2,258,000.

13
14 Q. Should the Company's rate base be adjusted to recognize its proposed adjustment
15 for post-test year additions to plant in service?

16 A. No. The Company's proposed adjustment is one-sided, in that it does not recognize
17 other changes that will be taking place after the end of the test year that will tend to
18 offset the revenue requirement effect of the additions to plant in service. In
19 particular, although the Company recognizes the increase in accumulated
20 depreciation directly related to the forecasted plant additions, it does not recognize
21 the growth in accumulated depreciation on embedded plant in service that will be
22 taking place as the new plant additions are going into service. The growth in the

1 accumulated reserve for depreciation will tend to offset the increase in revenue
2 requirements associated with the additions to plant in service.

3
4 Q. Why do you say that the growth in the accumulated reserve for depreciation will
5 tend to offset the effect of additions to plant in service?

6 A. In response to Information Request AG-2.3 the Company provided the balance of
7 net plant in service from December 31, 1997 through December 31, 2001. In each
8 year, the gross plant in service increased as a result of additions similar to those for
9 which the Company is proposing its adjustment. However, the accumulated reserve
10 for depreciation has also increased, and on balance that increase has mitigated the
11 effect of additions to plant in service. For example, although there was an increase
12 in gross plant in service of \$3,420,000 from 1997 to 2001, the increase in net plant
13 for this same period was only \$683,000, as a result of concurrent growth in the
14 accumulated reserve for depreciation

15 As the future additions take place and increase the balance of gross plant,
16 the accumulated reserve for depreciation will also continue to grow as a result of
17 recording depreciation expense on total plant in service. Therefore, the net plant
18 in service is increasing less than the gross plant in service. It is not appropriate to
19 allow a pro forma adjustment to increase rate base for post-test year plant
20 additions without recognizing the offsets to those additions that will be taking
21 place concurrently.

22
23 Q. What do you recommend?

1 A. The Commission should reject the Company's proposed pro forma adjustment to
2 reflect the forecasted increase in gas plant associated with post-test year additions.
3 This is not an adjustment for a known and measurable change. Rather, it is a
4 selective use of one isolated element of a forecasted test year. As such, the
5 Company's adjustment should not be incorporated into the Commission's
6 determination of rate base and revenue requirements.

7 In response to Information Request AG-3.3, the Company provided the
8 gross plant in service and the accumulated reserve for depreciation as of
9 December 31, 2002, six months after the end of the test year. If the Commission
10 is to approve any adjustment to recognize the effect of post test year plant
11 additions on rate base, I recommend that the adjustment be limited to growth in
12 net distribution plant in service through December 31, 2002. (There was no
13 growth in production plant or general plant.) The gross distribution plant in
14 service as of December 31, 2002 was \$27,587,000, which is \$1,420,000 less than
15 the pro forma distribution plant included in rate base by the Company (my
16 Schedule B-1). The related accumulated reserve for depreciation as of December
17 31, 2002 was \$14,041,000, which is \$53,000 greater than accumulated reserve for
18 depreciation on distribution plant reflected by the Company. Accordingly, I
19 recommend that the net distribution plant in service included in rate base be
20 reduced by \$1,473,000 (my Schedule B).

21

2. CASH WORKING CAPITAL

Q. Have you reviewed the development of the cash working capital allowance that the Company is proposing to include in rate base?

A. Yes. The Company's requested cash working capital allowance is based on a lead lag study that measures the cash working capital requirement resulting from the difference in time between the disbursement of cash in payment of expenses and the receipt of cash from customers for service rendered. The results of the lead lag study are summarized on UE Schedule B-5.2. Based on the lead lag study, the Company has included a cash working capital allowance of \$928,000 in its rate base.

Q. Are you proposing any modifications to the cash working capital requirement calculated by the Company?

A. Yes. I am proposing a modification to the lag assigned by the Company to Purchased Gas Adjustment ("PGA") revenues.

Q. How did the Company determine the lag that it assigns to PGA revenues?

A. The Company explains the calculation of the PGA revenue lag on AmerenUE Exhibit No. 6.0, Page 8. The lag is based on the method by which the Company determines the PGA factor used to recover the actual cost of gas. The PGA factor for a given month is designed to recover an estimate of gas cost for the current month, the actual gas costs for the second previous month, and a true-up of the difference between actual gas costs and estimated gas costs for the third previous

1 month. Taking these components of the PGA factor into account, the Company
2 calculated a weighted average lag of 60.81 days for PGA revenue.

3
4 Q. Is this appropriate?

5 A. No. The 60.81 days does not represent the lag in collection of PGA revenue.

6 Rather, the Company has described the method of calculating the PGA factor that
7 is applied to the current month consumption to determine the billing for purchased
8 gas in that month. The PGA factor may be based on prices for gas that are, on
9 average, two months old, but that PGA factor is applied to the current month's
10 consumption in determining the customer's bill. Unless there is some bias in the
11 determination of the PGA factor, the fact that the factor is based on data that are
12 two months old will not influence the lag in collection of PGA revenue. That is,
13 the price of gas will fluctuate from month to month. Sometimes using a two-
14 month old price will cause a temporary under-recovery and sometimes it will
15 cause a temporary over-recovery, but on balance, it should not influence the
16 timing of the recovery of purchased gas costs.

17 The method used by the Company to determine the lag applicable to PGA
18 revenue is the equivalent of assigning a lag of two-plus years to the recovery of
19 base rate revenue because a test year consisting of the twelve months ended June
20 30, 2002 is being used to determine base rates for a rate year ending June 30,
21 2004, or later. It would obviously be wrong to attribute such a lag to base rate
22 revenue, and it is similarly incorrect to attribute a two-month lag to PGA revenue.

1 Q. What do you recommend?

2 A. The Company has not identified any reason why the lag applicable to PGA
3 revenue should be different from lag applicable to base rate revenue. Therefore, a
4 lag of 40.16 days, the same lag applicable to base rate revenue, should be
5 assigned to PGA revenue. On my Schedule B-2, I have calculated that assigning
6 a 40.16 day lag to PGA revenue reduces the Company's cash working capital
7 requirement by \$557,000.

8

9 **3. ACCUMULATED DEFERRED INCOME TAXES**

10 Q. Are you proposing any adjustments to the accumulated deferred income taxes
11 ("ADIT") deducted from plant in service in the determination of rate base?

12 A. Yes. I am proposing to eliminate certain line items on UE Schedule B-5.6 from
13 the ADIT deducted from plant in service in the determination of rate base.

14

15 Q. Have you summarized the particular items that are you proposing to remove from
16 the ADIT deducted from rate base?

17 A. Yes. On my Schedule B-3, I have identified certain deferred tax debit balances
18 that are related to deferred credits or accrued liabilities that are not recognized in
19 the calculation of rate base. The Company has included these deferred tax
20 balances in the net ADIT deducted from rate base, but each of these items should
21 be removed.

22

1 Q. Please describe each of these items and explain why it should be removed from
2 the ADIT that go into the determination of rate base.

3 A. The first item is the deferred tax debit balance related to pension expense. This
4 represents deferred taxes related to the accrual of pension expense that is not
5 deductible for income taxes. The Company has not deducted the accrued liability
6 for pensions from rate base. Therefore, the deferred tax debit balance related to
7 the accrued pension liability should be eliminated from the ADIT that go into the
8 calculation of rate base.

9 The second item is the net deferred tax debit balance related to the accrued
10 liability for vacation pay. This item represents the deferred tax debit balance
11 related to the accrual of vacation pay that is not deductible for income taxes.
12 Again, the Company has not deducted the accrued liability for vacation pay from
13 rate base. Therefore, the deferred tax debit balance related to the accrued
14 vacation pay should be eliminated from the ADIT that go into the calculation of
15 rate base.

16 The third item is the deferred tax debit balance related to the accrual for
17 environmental cleanup costs. This item represents deferred taxes related to
18 accruals in excess of actual costs that can be deducted for income tax purposes.
19 The Company has not deducted any accrued reserve for environmental cleanup
20 costs from rate base. Therefore, the deferred tax debit balance related to this item
21 should be eliminated from the ADIT that go into the calculation of rate base.

22

1 Q. To your knowledge has the Commission accepted similar adjustments to remove
2 components of ADIT from the balance of ADIT deducted from rate base?

3 A. Yes. In Docket No. 01-0423, Commonwealth Edison Company, at page 45 of its
4 Interim Order, the Commission accepted an adjustment of \$64,737,000 to
5 eliminate certain elements from the balance of ADIT deducted from rate base.
6 The basis for this adjustment was that elements of ADIT related to accruals or
7 reserves that were not themselves deducted from rate base. I would also note that
8 in Docket No. 02-0837, Central Illinois Light Company, an affiliate of UE,
9 proposed to eliminate deferred taxes related to coal tar cleanup costs from rate
10 base on the grounds that the deferred costs themselves were not in rate base
11 (response to Information Request AG-1.8 in Docket No. 02-0837).

12

13 Q. What is the effect of your proposed modifications to the balance of ADIT
14 deducted from plant in service in the determination of rate base?

15 A. The net effect of my proposed modifications is to eliminate \$341,000 of deferred
16 tax debit balances (my Schedule B-3). This has the effect of increasing the rate
17 base deduction for ADIT by \$341,000 and reducing rate base accordingly.

18

19 **C. OPERATING INCOME**

20 **1. OPERATION AND MAINTENANCE EXPENSE**

21 Q. Are you proposing any adjustments to the pro forma operation and maintenance
22 expense included by UE in the determination of adjusted operating income under
23 present rates?

1 A. Yes. I am proposing adjustments to uncollectible accounts expense, wages and
2 salaries, pensions and benefits, meter reading expense, customer records and
3 collection expense, and rate case expense.

4

5 a. Uncollectible Accounts Expense

6 Q. How is the uncollectible accounts expense determined?

7 A. Uncollectible accounts expense is a component of operations and maintenance
8 expense. It is recorded to recognize that a portion of the accounts receivable that
9 are booked when bills are sent to customers might not ultimately be collected.
10 UE calculates the uncollectible accounts expense based on its estimate of
11 accounts that will be charged off. The offsetting credit is to a reserve account.
12 When individual accounts are actually written off as being uncollectible, the
13 reserve account is charged. Occasionally, if it is determined that the reserve is
14 either inadequate or excessive, an entry will be made to the uncollectible accounts
15 expense to adjust the reserve balance.

16

17 Q. What uncollectible accounts expense did UE charge to gas operation and
18 maintenance expense in the twelve months ended June 30, 2002?

19 A. UE charged uncollectible accounts expense of \$399,000 to gas operations expense
20 in the twelve months ended June 30, 2002 (response to Staff Data Request UE-
21 027). This is the amount of uncollectible accounts expense included in pro forma
22 test year operation and maintenance expense.

23

1 Q. Should the uncollectible accounts expense included by the Company in the cost of
2 service be modified?

3 A. Yes. The uncollectible accounts expense accrued in the twelve months ended June
4 30, 2002 appears to be abnormally high compared to other recent years; therefore
5 the uncollectible accounts should be adjusted to reflect experience more
6 representative of normal conditions.

7
8 Q. Why do you say that the uncollectible accounts expense accrued in the test year
9 appears to be abnormally high compared to other recent years?

10 A. The Company recorded the following uncollectible accounts expense for the years
11 1998-2002:

12	1998	108
13	1999	79
14	2000	108
15	2001	732
16	2002	(246)

17 The uncollectible accounts expense recorded in the twelve months ended
18 June 30, 2002 far exceeds the expense recorded in any of these years, except
19 2001, which overlaps with the test year. The negative uncollectible accounts
20 expense recorded in 2002 was apparently in recognition of the over-accrual for
21 uncollectible accounts expense in prior years.

22 Given that the accruals for uncollectible accounts are estimates of
23 accounts receivable that will ultimately be written off and given the fluctuations

1 in this expense, I believe that the uncollectible accounts expense recorded in the
2 test year should be normalized for the purpose of determining the Company's
3 revenue requirement in this case.

4

5 Q. What do you recommend?

6 A. I recommend that the uncollectible accounts expense included in pro forma test
7 year operation and maintenance expense reflect the average net write-offs of
8 uncollectible accounts as a percentage of revenues for the five years 1998 – 2002.

9 I am proposing to use this method rather than simply averaging the uncollectible
10 accounts over that five-year period because the actual uncollectible accounts
11 expenses booked by the Company during this five-year period were greater than
12 the amounts necessary to provide for the net write-off of uncollectible accounts.
13 I believe that five years is a reasonable basis for normalizing this expense because
14 it provides an adequate sample size without reaching too far back in time to
15 include data that might be obsolete.

16

17 Q. What is the effect of normalizing the uncollectible accounts expense based on the
18 five-year average of net write-offs?

19 A. As shown on my Schedule C-1, the average of net write-offs as a percentage of
20 revenues was 0.80% for the five-year period 1998-2002. Applying this percentage
21 to test year revenue, including PGA revenues, results in pro forma uncollectible
22 accounts expense of \$124,000. This is \$275,000 less than the actual uncollectible

accounts expense recorded by the Company in the test year. Accordingly, the pro forma test year uncollectible accounts expense should be reduced by \$275,000.

b. Wages and Salaries

Q. What adjustments are you proposing to wages and salaries included in test year operation and maintenance expense?

A. I am proposing three adjustments. First, I am proposing to modify the Company's adjustment to annualize the effect of wage increases. Second, I am proposing to eliminate incentive compensation. Third, I am proposing to recognize the effect of Ameren's early retirement program on wages and salaries.

Q. What modification are you proposing to the Company's adjustment to annualize the effect of wage increases?

A. One of the components of the Company's pro forma adjustment to wages and salaries is a 3.87% increase for management employees in 2003. Based on the response to Staff Data Request BCJ-3.09,

XX

XX

XX

XXXXXXXXXXXXXXXXXXXX

According to the response to BCJ-

3.09,XX

XX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXx Accordingly, it would seem to be more likely that the wage increases scheduled for management employees in 2003 will not take place than that the wage increase will take place. Therefore, the 2003 management wage increase should be eliminated from the pro forma adjustment to salaries and wages. This has the effect of reducing pro forma test year operation and maintenance expense by \$XXX (my Schedule C-1).

Q. Why are you proposing to eliminate incentive compensation from the Company's cost of service?

A. There are three incentive compensation programs – XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX Based on my review, the primary determinant of the amount of incentive compensation to be awarded pursuant to each of these programs is XXXX. Because the primary determinant of the incentive compensation is XXXXXXXXXXXX, elimination of this expense from the cost of service to be paid by ratepayers is appropriate.

Q. Why is it appropriate to eliminate incentive compensation on the grounds that the primary basis for determining the compensation to be awarded is XXX?

A. If the primary basis for awarding incentive compensation were safety, reliability, or cost control, then it would be reasonable to include such incentive compensation expenses in the cost of service. These are goals that benefit everybody, including customers.

1 However, XXXXXXXXXXXXXXXX, not a customer-oriented goal. For
2 example, all else equal, higher rates will result in higher revenues, which in turn
3 XXXXXXXXXXXXX. Thus, including incentive compensation related to XXX in the
4 revenue requirement would, in effect, require customers to reward company
5 management on a contingency basis for getting them to pay higher rates. If the
6 incentive compensation program is successful in XXXXXXXX, the shareholders
7 should be happy to reward management accordingly and absorb the cost of the
8 program. As shareholders are the primary beneficiaries of XXXXXXXX, it
9 should be those shareholders, not customers, that bear the cost of the incentive
10 compensation related to XXXX. Therefore, the incentive compensation based on
11 XXX should be excluded from the cost of service.

12
13 Q. What is the effect of eliminating incentive compensation from the Company's
14 cost of service?

15 A. As I show on my Schedule C-1, the effect is to reduce pro forma operation and
16 maintenance expense by \$XXXXXX.

17
18 Q. Please describe your proposed adjustment to recognize the effect of Ameren's
19 early retirement program on wages and salaries.

20 A. In response to Staff Data Request CIPS-069 in Docket No. 03-0008, estimates
21 were provided of savings to the UE gas department expenses XXXXX from
22 Ameren's early retirement program. XXXXXXXXXXXXXXXXthe savings should

1 be taken into account in the determination of the Company's revenue
2 requirements.

3 The available information estimates annual savings of \$XXXX in UE gas
4 department operation and maintenance expense from the Ameren early retirement
5 program. The estimated cost of the program allocable to the UE gas department
6 is \$XXXX. I recommend that for the purpose of calculating the net savings from
7 the early retirement program, the cost be amortized over ten years, resulting in a
8 net annual reduction to expenses of \$XXXX (my Schedule C-1).

9
10 Q. Why are you proposing an amortization period of ten years for the costs of the
11 early retirement program?

12 A. From the description provided, the cost of the program is primarily an accrual to
13 recognize XX Thus,
14 while these costs are accrued immediately for financial reporting purposes, the
15 actual disbursements will take place over many years in the future. In these
16 circumstances, I believe that a ten-year amortization period is reasonable. In
17 addition, the benefits to the Company will extend indefinitely into the future.
18 Therefore, a ten-year amortization period provides a better matching of costs and
19 benefits than would a shorter period.

20
21 c. Pensions and Benefits Expense

22 Q. What modifications to pro forma pensions and benefits expense are you
23 proposing?

1 A. The Company has proposed to adjust test year pensions and benefits expense
2 based on the budgeted pensions and benefits expense for 2003. The largest
3 components of this pro forma adjustment are the periodic pension cost accrued
4 pursuant to Statement of Financial Accounting Standards (“SFAS”) 87
5 (adjustment of \$133,000), and the periodic postretirement benefits other than
6 pensions cost (“OPEB”) accrued pursuant to SFAS 106 (adjustment of \$175,000).
7 The proposed adjustments for these two items combined are actually greater than
8 the total adjustment to pensions and benefits, as the adjustment for the other
9 components is, on balance, a reduction. I am proposing modifications to both the
10 Company’s pension adjustment and its OPEB adjustment.

11

12 Q. How did the Company adjust test year pension costs?

13 A. The Company adjusted test year pension costs to reflect the budgeted pension
14 costs for 2003. This results in a pro forma adjustment of \$175,000 to test year
15 operation and maintenance expense.

16

17 Q. What modification are you proposing to the Company’s calculation of pro forma
18 pension expense?

19 A. I am proposing to reflect the pro forma pension cost based on the complete
20 actuarial study for 2002, rather than on the budget for 2003.

21

22 Q. Why should the pro forma pension cost be based on the complete actuarial study
23 for 2002, rather than on the budget for 2003?

1 A. The budget is an estimate based on a forecast of pension costs in the future, rather
2 than a calculation based on the known inputs that will go into the actual
3 determination of the periodic pension cost. On the other hand, the calculation of
4 the periodic pension costs for 2002 reflect actual inputs into the determination of
5 periodic pension cost. Therefore, I believe that is reasonable to use the actuarial
6 studies for the 2002 periodic pension cost as the basis for the pro forma pension
7 expense to reflect in the cost of service. Use of the 2002 actuarial studies results
8 in an increase of \$19,000 in the pension expense allocated to the gas department
9 over the expense for the twelve months ended June 30, 2002, as compared to the
10 \$175,000 increase in the Company's adjustment. Thus, use of the 2002 actuarial
11 study results in a \$156,000 reduction to the pro forma test year operation and
12 maintenance expense calculated by the Company (my Schedule C-1).

13

14 Q. How did the Company adjust test year OPEB costs?

15 A. The Company adjusted test year OPEB costs to reflect the budgeted OPEB costs
16 for 2003. This results in a pro forma adjustment of \$133,000 to test year
17 operation and maintenance expense.

18

19 Q. What modifications are you proposing to the Company's calculation of pro forma
20 OPEB expense?

21 A. Again, I am proposing to reflect the pro forma OPEB cost based on the complete
22 actuarial study for 2002, rather than on the budget for 2003. The reasons for this
23 proposed modification are substantially the same as the reasons for the proposed

1 modification to the Company's pro forma adjustment to pension expense, that is
2 that it is more appropriate to rely on the complete actuarial study for this cost,
3 rather than on the estimate of this cost budgeted for 2003.

4
5 Q. Have you quantified the effect of your proposed modification to the Company's
6 pro forma adjustment to OPEB expense?

7 A. Yes. Use of the 2002 actuarial studies results in a decrease of \$20,000 in the
8 OPEB expense allocated to the gas department over the expense for the twelve
9 months ended June 30, 2002, as compared to the \$133,000 increase reflected in
10 the Company's adjustment. Thus, use of the 2002 actuarial study results in a
11 \$153,000 reduction to the pro forma test year operation and maintenance expense
12 calculated by the Company (my Schedule C-1).

13
14 d. Meter Reading Expense

15 Q. What costs are included in Account 902, Meter Reading Expenses?

16 A. This account includes the cost of labor and materials and supplies associated with
17 reading customer meters.

18
19 Q. What was the amount of non-labor costs charged to Account 902 in the twelve
20 months ended June 30, 2002?

21 A. UE charged \$180,000 of non-labor costs to Account 902 in the twelve months
22 ended June 30, 2002.

1 Q. How does this compare to the charges to meter reading expenses in other recent
2 years?

3 A. As can be seen in the response to Staff Data Request UE-008, Page 2, the amount
4 for the twelve months ended June 30, 2002 significantly exceeds the amounts for
5 any of the other recent years except 2001, which overlaps the test year. For
6 example, in 2000 the amount charged to Account 902 was \$78,000.

7
8 Q. Did the Company explain the reason for the increased level of non-labor expense
9 charged to Account 902 for 2001 and for the twelve months ended June 30, 2002?

10 A. Yes. The response to Staff Data Request UE-ENG 1.26 states that in the test year
11 and 2001, “there was a concerted effort to read every single meter more
12 consistently than had been done in the past.” The response went on to say that
13 there was “an effort to make the transition to a new billing system as seamless as
14 possible to the customers and deliver exceptional service in the transition.” Based
15 on this explanation, it would appear that some of the costs charged to meter
16 reading expense in 2001 and the test year were abnormal and non-recurring, in
17 that once the transition is complete, the costs associated with the transition will no
18 longer be incurred.

19
20 Q. Should the actual non-labor costs charged to Account 902 for the twelve months
21 ended June 30, 2002 be adjusted?

22 A. Yes. To the extent that Account 902 includes costs that are abnormal or of a non-
23 recurring nature, the expenses charged to that account should be normalized for

1 the purpose of determining pro forma test year operation and maintenance
2 expense. The expenses charged to Account 902 should be adjusted to normalize
3 the effect of the costs associated with the transition to a new billing system, as
4 such expenses will not be incurred on a continuing basis prospectively. I have
5 calculated that the average non-labor expenses charged to Account 902 for the
6 years 1998-2001 were \$99,000. This is \$81,000 less than the non-labor expenses
7 charged to Account 902 in the twelve months ended June 30, 2002. Accordingly,
8 I recommend that pro-forma test year operation and maintenance expense be
9 reduced by \$81,000 to normalize the non-labor expenses charged to Account 902,
10 Meter Reading Expenses (my Schedule C-1).

11
12 e. Customer Records and Collection Expenses

13 Q. What costs are included in Account 903, Customer Records and Collection
14 Expenses?

15 A. This account includes the cost of labor and materials & supplies associated with
16 work on customer applications, contracts, orders, credit investigation, billing and
17 accounting, collections, and complaints.

18
19 Q. What was the amount of non-labor costs charged to Account 903 in the twelve
20 months ended June 30, 2002?

21 A. UE charged \$204,000 of non-labor costs to customer records and collection
22 expenses in the twelve months ended June 30, 2002.

1 Q. How does this compare to the charges to customer records and collection
2 expenses in other recent years?

3 A. As can be seen in the response to Staff Data Request UE-008, Page 2, the amount
4 for the twelve months ended June 30, 2002 significantly exceed the amounts for
5 any of the other recent years except 2001, which overlaps the test year. For
6 example, in 2000 the amount charged to Account 903 was \$31,000.

7
8 Q. Did the Company explain the reason for the increased level of non-labor expense
9 charged to Account 903?

10 A. Yes. The response to Information Request AG-3.18 states that the increase in
11 expenses from prior years was “due to an increase in charges for outside
12 contractor customer phone service due to training of company employees on new
13 customer service system.” Based on this explanation, it would appear that the
14 increase in costs charged to customer records and collection expenses was
15 abnormal and non-recurring, in that once the training of company employees on
16 the new customer service system is complete, the costs associated with the
17 training will no longer be incurred.

18
19 Q. Should the actual non-labor costs charged to Account 903 for the twelve months
20 ended June 30, 2002 be adjusted?

21 A. Yes. Again, to the extent that Account 903 includes costs that are abnormal or of
22 a non-recurring nature, the expenses charged to that account should be normalized
23 for the purpose of determining pro forma test year operation and maintenance

1 expense. The expenses charged to Account 903 should be adjusted to normalize
2 the effect of the costs associated with the training of employees on the new
3 customer service system, as such expenses will not be incurred on a continuing
4 basis prospectively. I have calculated that the average non-labor expenses
5 charged to Account 902 for the years 1998-2001 were \$74,000. This is \$130,000
6 less than the non-labor expenses charged to Account 903 in the twelve months
7 ended June 30, 2002. Accordingly, I recommend that pro-forma test year
8 operation and maintenance expense be reduced by \$130,000 to normalize the non-
9 labor costs charged to Account 903, Customer Records and Collection Expenses
10 (my Schedule C-1).

11
12 f. Rate Case Expense

13 Q. What level of costs associated with the present rate case has UE included in pro
14 forma test year operation and maintenance expense?

15 A. UE is proposing to amortize the costs of the present case, which it estimates at
16 \$237,000, over three years. This results in annual expense of \$79,000 (UE
17 Schedule C-11) for costs associated with the present rate case.

18
19 Q. Are you proposing any modifications to the Company's rate case expense?

20 A. Yes. I am proposing two modifications. First, this case has been consolidated
21 with ICC Docket No. 03-0008, the Central Illinois Public Service Company (an
22 affiliate of UE) gas rate case. The Company has split the cost of the rate cases
23 50/50 between CIPS and UE. As the CIPS jurisdictional operations are

1 significantly larger than the UE jurisdictional operations, I believe that it would
2 be more reasonable and more equitable to allocate the rate case costs between the
3 two affiliates based on their relative size. As a measure of relative size for the
4 two gas distribution utilities, I have used the proposed rate base. Allocating the
5 combined cost of the two rate cases of the two the utilities based on their
6 proposed rate bases results in \$41,000 of rate case cost being allocated to UE (my
7 Schedule C-1). I am proposing to amortize this cost over five years.

8
9 Q. Why are you proposing an amortization period of five years?

10 A. The Company's last case was decided February 18, 1999. By the time that the
11 Commission issues an order in this case, nearly five years will have passed. As
12 the amortization period for rate case costs should reflect the reasonable
13 expectation of the time between rate cases, I am proposing an amortization period
14 of five years, based on the time since the Company's last rate case.

15
16 Q. What is the effect of your proposed modifications to the Company's
17 determination of annual rate case expense?

18 A. The effect is to decrease the annual rate case expense by \$71,000 (Schedule C-1).
19

20 **2. DEPRECIATION EXPENSE**

21 Q. Are you proposing any adjustments to pro forma test year depreciation expense?

22 A. Yes. In my testimony on rate base, I proposed to modify the Company's
23 adjustment to rate base for post-test year plant additions. Consistent with that

1 adjustment to plant in service, the depreciation expense included in the cost of
2 service should be modified. My adjustment to depreciation expense on post-test
3 year additions to plant in service reduces pro forma depreciation expense by
4 \$34,000 (my Schedule B-1).

5
6 **3. TAXES OTHER THAN INCOME TAXES**

7 Q. Are you reflecting any adjustments to taxes other than income taxes in your
8 calculation of pro forma operating income?

9 A. Yes. I have proposed certain adjustments to reduce the wages and salaries
10 included in test year operation and maintenance expense above. Consistent with
11 those adjustments, I am also eliminating the payroll taxes on those wages and
12 salaries. The adjustment to taxes other than income taxes is shown on my
13 Schedule C-2.

14
15 **4. INCOME TAXES**

16 Q. Please explain your adjustment to income tax expense.

17 A. The calculation of my adjustment to income tax expense is shown on Schedule C-
18 3. This schedule shows the adjustments to taxable income from the other
19 adjustments to operating income that I am proposing. I also calculate the
20 adjustment to interest expense (calculated by applying the weighted cost of debt
21 included in the overall rate of return to rate base) resulting from my proposed
22 adjustments to rate base. I apply the state income tax rate to the adjustments to

1 taxable income to calculate the adjustment to state income tax expense, and apply
2 the federal income tax rate to the adjustments to taxable income net of state
3 income taxes to calculate the adjustment to federal income tax expense. This is
4 generally consistent with the method used by the Company to calculate income
5 tax expense.

6
7 Q. Other than changes to taxable income resulting from adjustments to revenue and
8 operating expenses, are you proposing any modifications to the Company's
9 determination of pro forma income tax expense?

10 A. Yes. I am proposing two adjustments.

11 The first adjustment is to reflect the negative taxable income (before my
12 proposed adjustments to revenue and expenses other than income taxes) in my
13 calculation of income tax expense. UE did not compute income taxes on the
14 negative taxable income that it calculated. Rather, the Company assumed a
15 current income tax expense of zero and then treated the portion of the increased
16 revenue from the proposed rate increase necessary to bring the taxable income up
17 to zero as being exempt from income taxes. I have reflected the income taxes on
18 the negative taxable income in my calculation of income tax expense. Consistent
19 with this treatment, the effect of any rate increase necessary to eliminate the
20 revenue deficiency would be fully subject to income tax. This method does not
21 differ in substance from the Company's method. However, the presentation is
22 different.

1 The second adjustment is to deferred income tax expense. The response to
2 Information Request AG-3.8 provides support for the Company's calculation of
3 deferred income tax expense. The net deferred tax expense in this response is
4 \$41,000 less than the deferred tax expense reflected on UE Schedule C-6. The
5 deferred taxes in the response to Information Request AG-3.8 appear to be
6 calculated correctly. Therefore, I have reflected a reduction to deferred income
7 tax expense of \$41,000 in my income tax calculation on my Schedule C-4.

8
9 **D. GROSS REVENUE CONVERSION FACTOR**

10 Q. What is the gross revenue conversion factor?

11 A. The gross revenue conversion factor is applied to the operating income deficiency
12 (calculated as the difference between the operating income necessary to produce
13 the authorized return and the adjusted operating income under present rates) to
14 determine the additional revenue required to make up that operating income
15 deficiency. UE calculated a gross revenue conversion factor of 1.69296 (UE
16 Schedule C-14).

17
18 Q. Are you proposing any modifications to that gross revenue conversion factor?

19 A. Yes. One of the elements of the gross revenue conversion factor is the allowance
20 for uncollectible accounts. The Company has assumed a 1.97% uncollectible
21 accounts factor, based on the actual experience for the twelve months ended June
22 30, 2002. As I stated above, the write-off of uncollectible accounts for the twelve
23 months ended June 30, 2002 appears to have been abnormally high. I recommend

1 using a five-year average uncollectible accounts percentage for the purpose of
2 calculating the gross revenue conversion factor. Based on the response to
3 Information Request AG-3.11, over the five years ended 2002, the uncollectible
4 accounts as a percentage of gross revenue averaged 0.80%. I have incorporated
5 this uncollectible accounts percentage into my computation of the gross revenue
6 conversion factor on my Schedule A. The resulting gross revenue conversion
7 factor is 1.6730.

8
9 Q. Does this conclude your testimony?

10 A. Yes.